KPMG

Value Added Tax Overview

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Notices

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Agenda

VAT around the world

How VAT Works

VAT Challenges in the Digital Economy

VAT Around the World

VAT in a nutshell

General tax

- Tax applies to all sales of goods, services, and intangibles
- Few exemptions: financial services, real estate, basic food products

Global tax

- More than 165 countries have a VAT
- 20% of OECD average tax revenue v. 8% for corporate income taxes*
- Average tax rate: 19% for OECD countries

Consumption tax

- The final consumer in general bears the economic burden of the tax
- Tax generally applies where consumption occurs and not where production occurs

Indirect tax

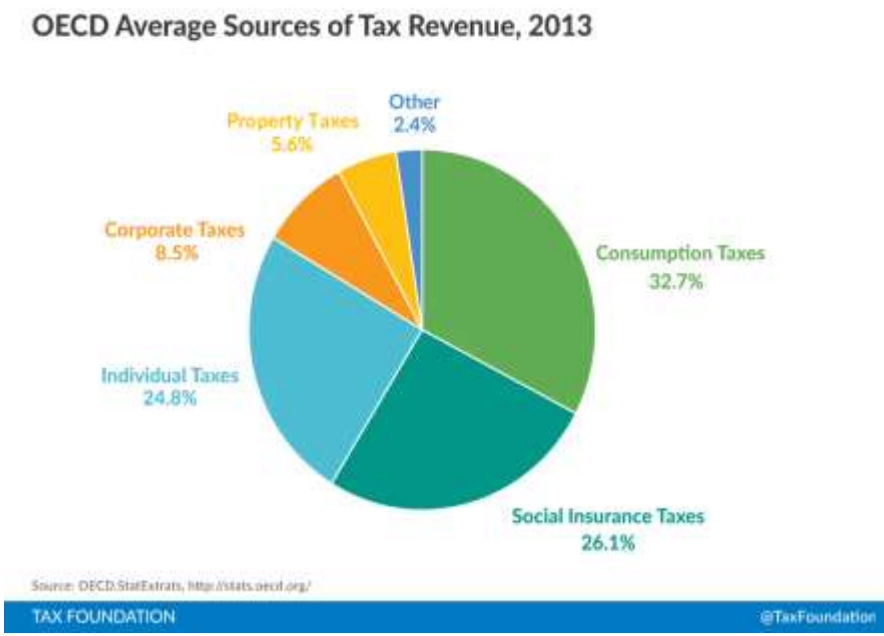
- The tax applies on each transaction
- Businesses act as tax collectors
- Not a tax on business entities

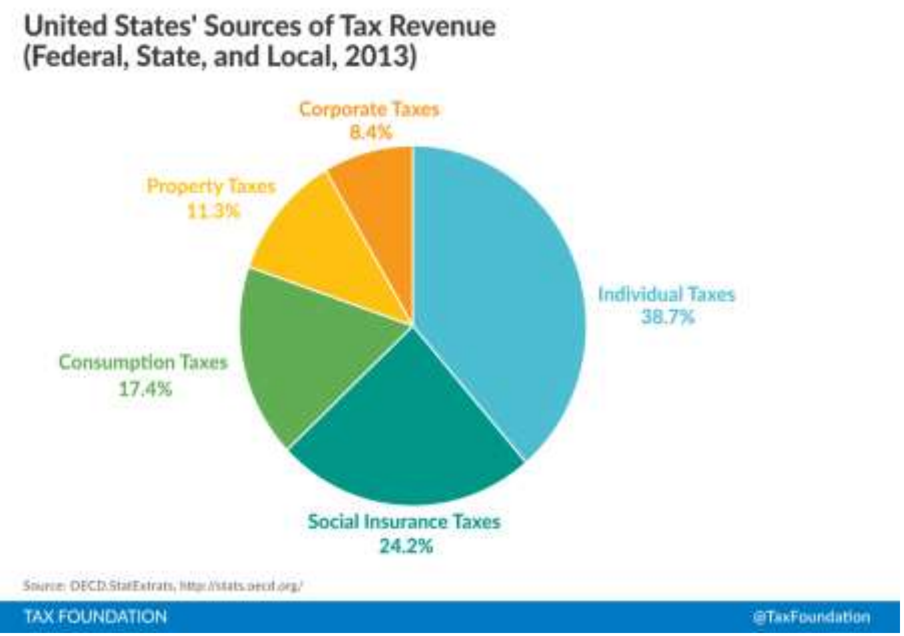
Neutral for businesses

- VAT incurred on purchases is generally creditable
- Exceptions: when making exempt sales or specific purchases

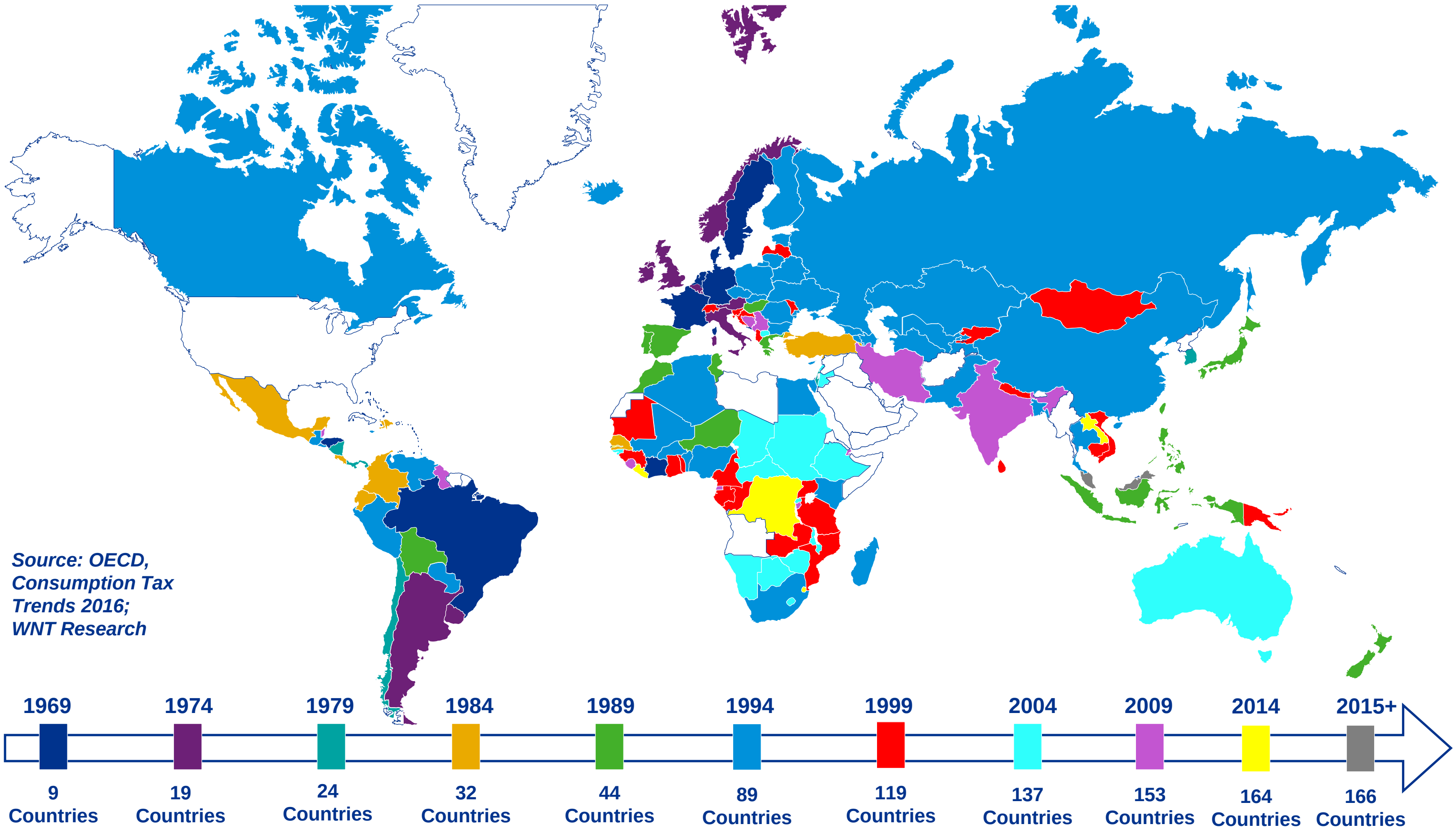
*OECD, Consumption Tax Trends 2016

The U.S. and Consumption Taxes





VAT enactments timeline



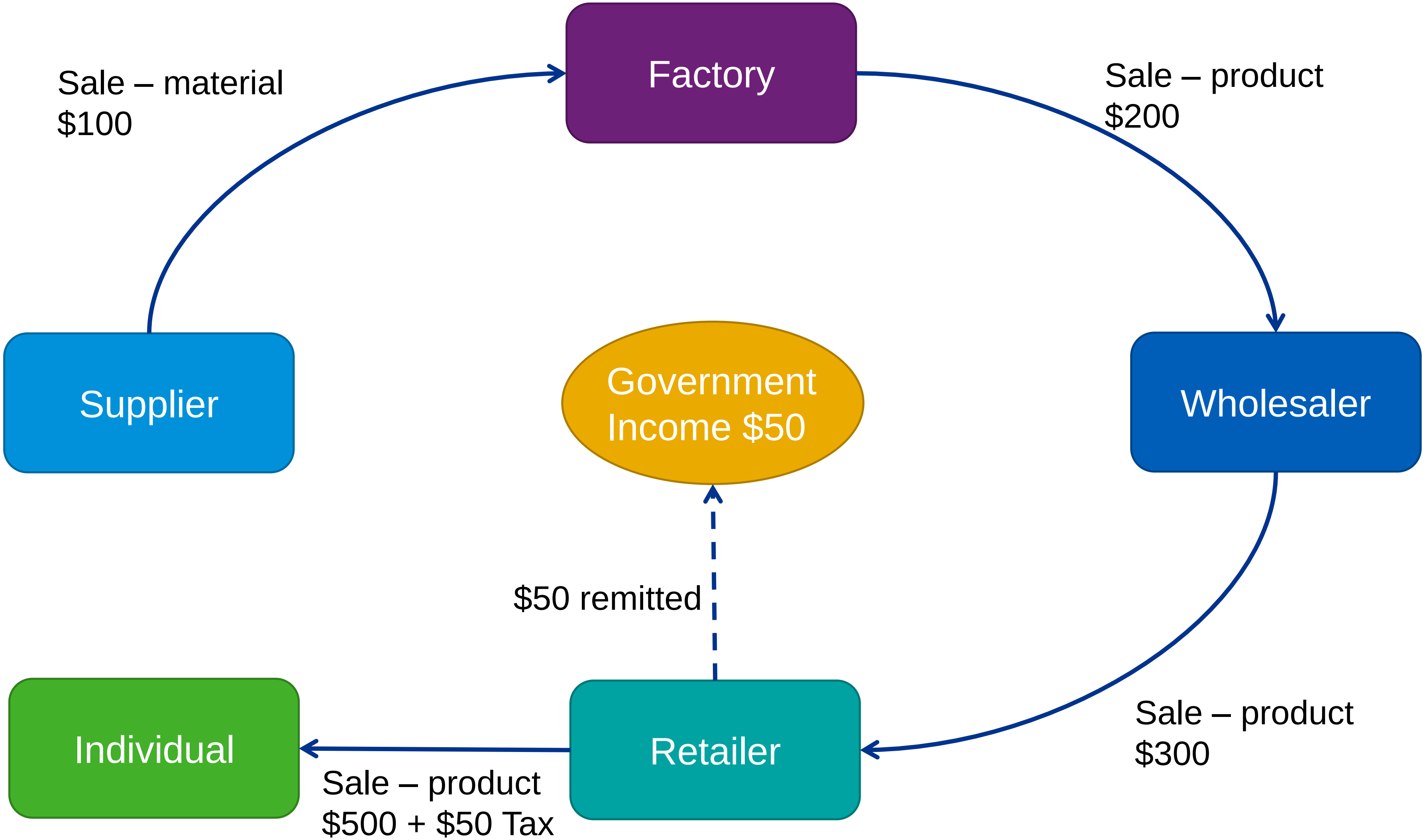
Source: OECD, Consumption Tax Trends 2016; WNT Research

How VAT Works

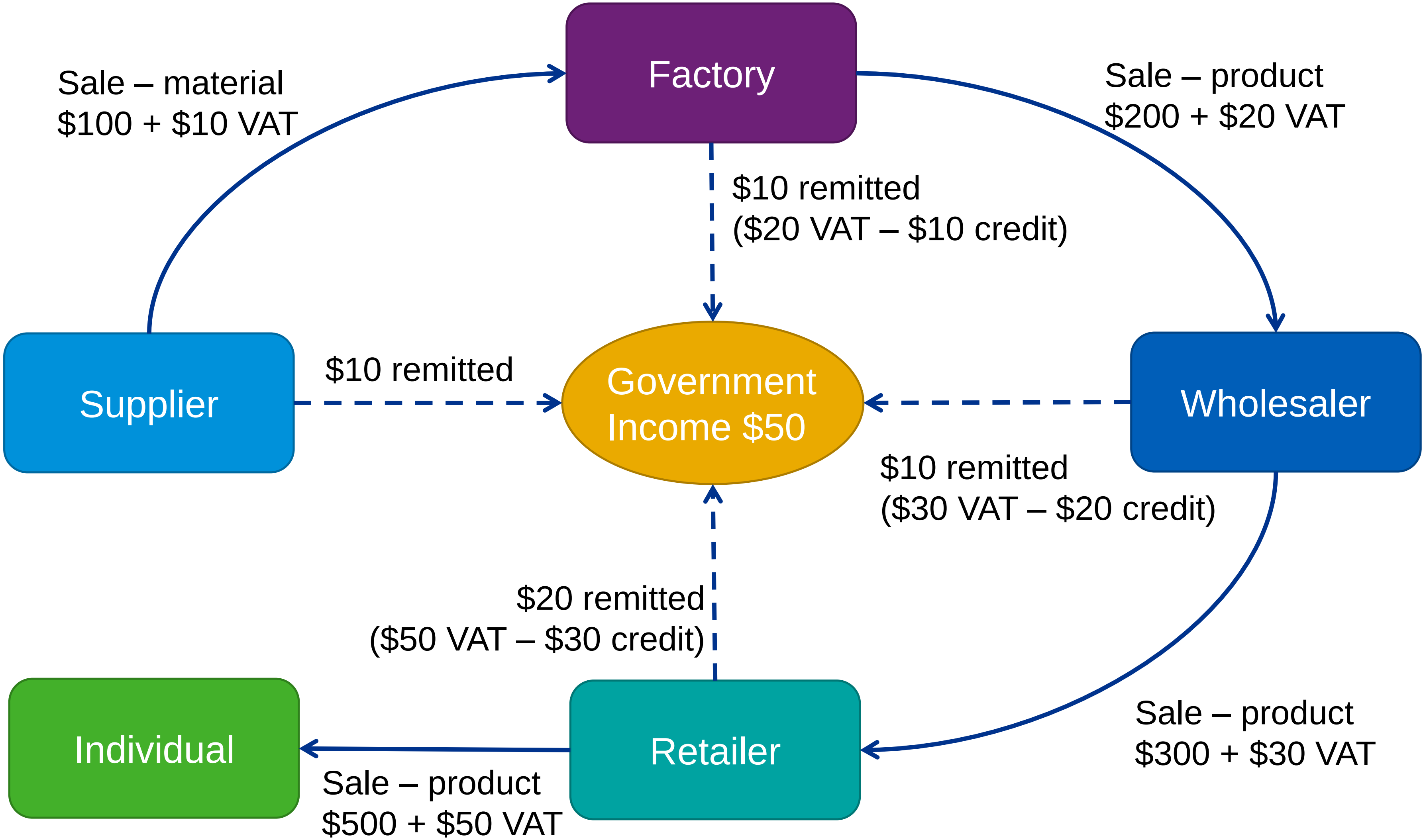
VAT/GST vs. RST

	VAT/GST	RST
Taxpayer?	Sellers (or buyers) of taxable goods and services	Sellers (or buyers) of taxable goods and services with physical presence
What?	All goods and services	All tangible personal property and enumerated services
Where?	Where goods/services are consumed	Where goods/services are received/enjoyed
When?	At each stage of consumption chain	Sale to end consumer
Tax base?	Sales price	Sales price
Tax burden?	End consumer	End consumer and businesses when transaction is non-exempt

Retail sales tax example



How does VAT work?



Operation of VAT

VAT rate = 10%	Sells	VAT return	Govt. gets
Supplier (raw materials)	$100 + $10	10.00	$10.00
Factory [buys 100 + 10]	$200 + $20	20.00 (10.00)	$10.00
Wholesaler [buys 200 + 20]	$300 + $30	30.00 (20.00)	$10.00
Retailer [buys 300 + 30]	$500 + **$50**	50.00 (30.00)	$20.00

Total: **$50.00**

VAT terminology

Output tax

- VAT charged by businesses on sales made to their customers
- "Output" meant to reflect outgoing sales

Input tax

- VAT spent by businesses on qualifying business expenditures
- "Input" meant to reflect incoming purchasing

Supply

- VAT terminology for a "sale"
- Goods: tangibles; Services: intangibles

Consideration

- Payment received in return for the supply of goods or provision of services
- Generally, "everything received in return for the supply of goods and services,…"

Reverse charge mechanism

- Situation in which seller of services (usually foreign) is not liable for VAT, and instead buyer is required to account for VAT

— Note the focus on movement on goods/services, rather than movement of money

VAT rates

Standard	• EU VAT rates range from 17% to 27%. Average EU VAT rate is approaching 21.5% – somewhat less in ASPAC and LATAM
Reduced	• Any rate lower than the standard rate • E.g., basic food stuff, books – usually political decision
Zero-rated	• No VAT is charged, but seller **HAS** a right to credit input tax • E.g., exported goods and services
Exempt	• No VAT is charged, but the seller **HAS NO** right to credit input tax • E.g., certain financial, medical and education services
Outside scope	• Not within the scope of VAT in the jurisdiction concerned • E.g., charities and non-business

Chargeability and recovery

Distinction made between	Output tax charged	Input tax recoverable
Taxable	✓	✓
Zero – rate	✗	✓
Exempt	✗	✗

Proffered Rationale for VAT

Why do jurisdictions adopt VAT?

- Broad-based tax
  - From policy perspective, broad-based taxes more desirable than applicable to narrow set of transactions or taxpayers
  - VAT may help to stabilize revenue and less volatile than personal and corporate income tax
- Revenues collected sooner
  - Because revenues are collected at each stage, governments receive tax revenue sooner than waiting for tax revenue from retail sales tax or excise taxes
- Simple Administration
  - Taxpayers collect VAT for the government
  - No need of exemption certificates
  - Improvement in technologies are making administration and compliance easier
- Taxes consumption and not savings, investments, or business inputs

Why do jurisdictions adopt VAT? (continued)

- Neutral, growth friendly tax
  - Sales tax meant to be collected at final point of sale, but not necessarily so in practice (business inputs often taxed)
  - By collecting taxes throughout process, VAT system is able to avoid cascading tax effect
- Favorable to international trade
  - Domestic and foreign products treated equally:
    - Generally, exports are not subject to VAT, but imports are subject to VAT

VAT in the U.S?

Key issues in design of a U.S. VAT

- Choice of VAT structure
  - Addition, subtraction, credit-invoice
- Choice of VAT base (assuming credit-invoice)
  - Dealing with essentials; filing thresholds
- Choice of VAT rate
- Single rate vs. multiple rates
  - Dealing with regressivity
- “Inside the tax” or “outside the tax”
  - Structuring credits, exemptions and expenditures
- Dealing with special sectors
  - Housing, financial services, government, nonprofits
- Administration
  - Who collects?

Key design issues – Coordination

- State and local officials generally view VAT as encroachment on traditional sub-national source
  - Potential crowding out in the consumption tax space
  - Potential calls to cede policy and administrative control to federal government
- Federal VAT could improve structure of sales taxes
  - Potential for improving structure and operation of retail sales taxes
  - Potential for improving sales tax compliance
  - Potential for reducing sales tax compliance burden
- Would require accommodation by state officials
  - Greatest improvements flow from close coordination with federal

VATs in a Federal System

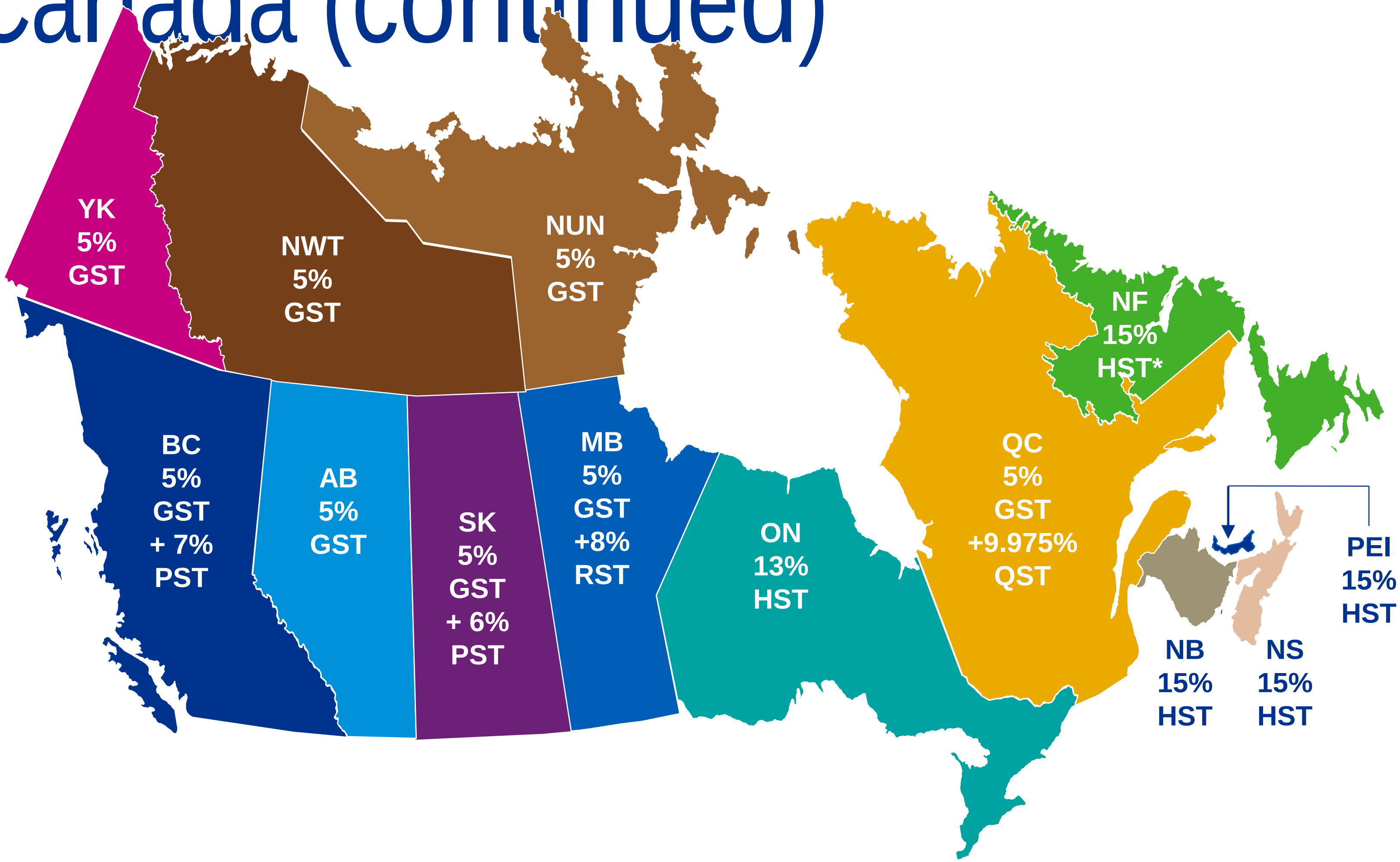
Canada

Overview of indirect taxes in Canada

— Federal level:
  - Goods and services tax (GST): credit-invoice method levied at a rate of 5% and administered by the Canadian Revenue Agency (CRA)

— Provinces and territories level
  - No local tax – 4 jurisdictions
  - Provincial sales tax (PST): retail sales tax similar to the U.S. states' retail sales tax – 3 jurisdictions
  - Harmonized sales tax (HST): local taxes are harmonized with GST whereby the tax rate comprises a federal and a provincial portion – 5 jurisdictions
  - Quebec sales tax (QST): rules are broadly harmonized with GST, but it is a separate tax and is administered by Revenue Quebec

Overview of indirect taxes in Canada (continued)



HST

- HST combines a federal component (i.e., 5% GST) and a provincial component
- Same tax base and rules as GST
- Administered by the Canada Revenue Agency (CRA)
- A person registered for GST is also registered for HST
- One combined GST/HST return
- Specific rules to HST
  - HST place of supply rules
  - Recaptured input tax credits (RITCs) in some HST provinces
  - A few point-of-sale rebates for provincial component of HST
- Various special calculations for some financial institutions including pension plans

India

Indirect taxes levied in India

Indirect tax	Taxing authority	Applicable on
Excise duty	Federal government	Manufacture of goods in India
Service tax	Federal government	Provision of taxable services
Central sales tax (CST)	Federal government	Inter-state sale of goods
VAT	State governments	Sale of goods within the state
Entry tax/octroi	State governments/local authorities	Entry of goods in state/local area for consumption, use or sale

Structure Proposed for GST in India

Framework	Coverage	Rates
Levy: Tax on all supplies (including stock transfers); **Mechanics:** Dual GST: CGST for Centre (federal) and SGST for states; IGST on inter-state supplies **Situs:** Place of supply rules (sourcing rules) to determine situs of supply of goods & services **Credits:** Full credit of all GST paid, except cross credits between CGST and SGST	**Subsumed**: Excise duty, Countervailing Duty (CVD), Special Additional Duty (SAD), Service tax, state VATs, Central Sales Tax (CST), Entry tax, Purchase tax, Entertainment Tax, Luxury Tax, Cesses **Excluded products:** Alcohol for human consumption, Petroleum products	**Rate structure:** Finalized as per the latest GST Council meeting: — Lower Rate – 5% — Standard Rate –12% and 18% — Higher Rate – 28% — Sin / Demerit Rate – 28% + Cess (for specified goods) **Rate Schedule**: yet to be released

Mechanics of GST Levy

— Dual GST will consist of CGST and the SGST, which in themselves, would include both Goods Tax and the Services Tax

Present Structure

Intra-state sale of goods	Rate	100
Excise Duty	12.5%	12.50
Value Added Tax (VAT)	5%	5.63
Total Invoice Value..		118.13

Inter-state sale of goods	Rate	100
Excise Duty	12.5%	12.50
Central Sales Tax (CST)	2%	2.25
Total Invoice Value..		114.75

GST Structure

Intra-state supply of goods	Rate	100
CGST	9%	9
SGST	9%	9
Total Invoice Value..		118

Inter-state supply of goods	Rate	100
IGST	18%	18
…………	….	….
Total Invoice Value..		118

*** Calculations are made assuming GST of 18% and State and Centre share equally**

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